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Author:

Munro, Hugh

Title:

Artificial restrictions on
consumption and how to...

Place:

Dingwall

Date:

[1935]

94-82024-6

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BUSINESS	
111	
Munro, Hugh.	
... Artificial restrictions on consumption and how to remove them; the repayment of national debt, by Hugh Munro ...	
Dingwall, G. Souter [1935]	
cover-title, 27 p. diagr. 21 ^{cm} .	
At head of title: Economic research.	
1. Consumption (Economics) 2. Over-production. 3. Credit — Gt. Brit. i. Title. ii. Title: The repayment of national debt. iii. Title: Economic research.	
36-7320	
Library of Congress	HD61.M8 1935
Copyright A ad int. 21120	[3] 338.01

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TECHNICAL MICROFORM DATA

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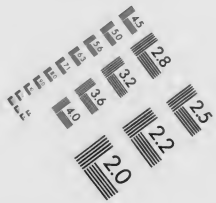
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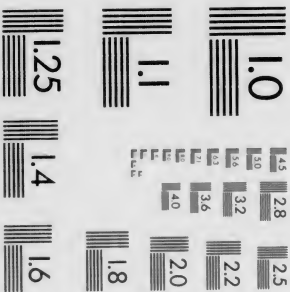
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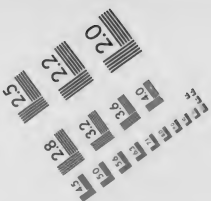
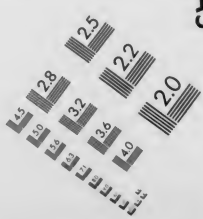
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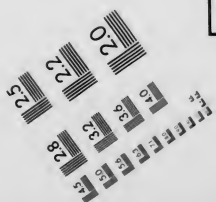
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ECONOMIC RESEARCH

Artificial Restrictions on Consumption

And How to Remove Them

The Repayment of
National Debt

BY

HUGH MUNRO, B.Sc., M.I.Mech.E.



GEORGE SOUTER, PUBLISHER, DINGWALL

Price 1/-

Chronicle, Inverness.

Business

July
1947

JUL 14 1947 PCR

Part I.

Rationalised Consumption.

Non-Expanding Output.

1. OVERPRODUCTION.—An outstanding characteristic of modern economics is that phenomenon which may be called either 'Underconsumption' or 'Overproduction.' Overproduction, as it will be called here, breaks down any attempt to maintain a constant price level, it is fatal to the industrial prosperity of a money-using community where prices are free to find their supply and demand level, and it may appear in two forms:—

- (a) In the sense that there may be accumulations of goods which people would consume if they had money to buy them, and
- (b) In the sense that people, having the money to buy accumulated goods, have all the goods they want and wish no more.

The former is 'Apparent Overproduction' or 'Real Underconsumption,' and the latter is 'Real Overproduction' or 'Apparent Underconsumption.' Producers may prevent real overproduction by concerted action among themselves to regulate output, either alone or in co-operation with the State. Such regulation, usually known under the name of 'Rationalisation,' is actually in force to prevent overproduction of wheat, rubber, tin, coffee, &c. We shall assume that real overproduction may be prevented effectually by that process, and that apparent overproduction or real underconsumption alone remains to be dealt with. 'Real Underconsumption' will in future be referred to always as 'Apparent Overproduction.'

2. PREVENTION OF APPARENT OVERPRODUCTION—GENERAL PRINCIPLES.—Assume the existence of a small community which has a factory system and a market system, and which uses money as the sole medium of exchange. The factory system performs all industrial operations from the winning of raw material to the production of finished goods and to their sale to the ultimate purchaser. To begin with, this community has no capital goods such as factory buildings and machinery. Its sole output consists of consumption goods such as bread, butter, boots, clothes, &c. Material enters the factory system and is converted into goods at the constant average rate of 100 tons per week. Money also enters the factory at the constant average rate of £100 per week, where it is paid out as the cost of producing 100 tons of goods. The community is satisfied with, and can consume 100 tons per week for real overproduction has been eliminated. But before the members of the community can consume those goods, they must first purchase them from the producers, who must recover all their costs. In order that all the goods may be purchased and all costs recovered by producers, the condition to be observed is:—‘The amount of money which appears in the market each week to purchase the total output of 100 tons per week must be equal to the gross cost of producing those goods.’ That procedure is represented graphically in fig. 1 in the Supplement, page 15.

The ‘gross cost of producing those goods’ is the amount of money paid out as wages, salaries, rent, interest, royalties, monopolies, taxes, profits, &c. People who receive those sums direct from the factory, including factory owners who receive salaries and profits, pay some of the money away voluntarily for the services of doctors, lawyers, amusement caterers, &c. Everyone who thus receives money either directly or indirectly from the factory must pay some of it away as taxes to the State. The State pays this tax money to its servants, contractors, and bond holders, and to old age pensioners, unemployed, &c. The money is shuffled and reshuffled, and every person who receives money must pass it on as payment for goods or services or taxes. No one

may hoard money nor withdraw it from circulation nor export it, and finally it arrives in the market, for it can go no other where, at the average rate of £100 per week, where it is spent in purchasing goods at the average rate of 100 tons per week which had cost £100 in the factory. Profits are spent in buying goods and entitle the recipients to a greater share of the total output. The whole output is sold, there is no excess of money nor of goods, there is neither real nor apparent overproduction, consumers have enough and are satisfied, and producers have recovered all their costs, including profit. **The money issued by the factory system is sufficient to purchase all its output, provided that people who receive that money, either directly or indirectly, do not prevent it from reaching the market.** Items representing financial rights such as profit, interest, royalty, &c., merely entitle the recipients to a share of the total output, and the fact that those items are included in cost does not, *per se*, prevent the sale of the total output of 100 tons per week to members of the community. All the weekly output having been sold and traders having recovered all the money (costs) which they had distributed, they employ it again to produce another lot of goods, which are sold in turn and all the money again recovered, and so on indefinitely. Money flows in a closed circuit, but goods enter the system, pass through the factory and market, out of the exchange system, and do not return, see fig. 2.

100 tons, the total weekly output, is produced for £100 and sold for £100, and the unit cost and unit price of the total factory output is £1 per ton. £1 per ton is the ‘Price Level,’ and it will be the endeavour of the community to keep the price level constant at all times.

3. SPURIOUS SAVING.—Assume that the community has been producing goods at the average rate of 100 tons per week, the gross cost of which is £100. £100 of money, and 100 tons of goods worth £100, emerge from the factory each week. They go to the market more or less directly, where, on the average, 100 tons are sold per week for £100. The

average rate of sale is equal to the average rate of production and there is neither real nor apparent overproduction.

An individual 'A' now begins to save money. He saves £1, and the first result of that saving is that one pound's worth of goods remain unsold. 'A' now possesses capital and he engages in trade. He returns his capital of £1 into the factory to pay the gross costs of producing goods which he proposes to sell at a profit. That £1 of money, and goods worth £1, emerge from the factory, and there is money in circulation to pay for these goods, but the goods which 'A' did not buy when he saved £1 are still unsold, and there is no money in circulation to pay for them. The £1 which 'A' saved, by preventing it from going to the market, and which he returned to the factory to pay for the production of more goods, **has been used to pay for the production of two tons of goods**, each ton costing £1. That £1 has been diverted from purchasing one of those tons, and one ton remains unsold. The owners of the unsold goods must get rid of them, so they restrict output by dismissing men or working short time. Incomes are reduced, the rate of consumption falls, there is **apparent** overproduction and trade depression, and prices fall.

The primary cause of this economic depression has been: 'Money which had been paid for the production of goods in the factory system has been diverted (by 'A') from the purchase, in the market, of goods of equal value, and goods of that value remain unsold.' That process will be called 'Spurious Saving,' see fig. 3. The saved money is returned to the factory to produce more goods (in practice it is frequently exported) and the unsold goods cannot now be sold without a fall in prices. Spurious saving appears in many forms, and in one form or another it is the general cause of apparent overproduction, or of the condition known as 'Poverty in the Midst of Plenty,' which exists throughout the world to-day. It is practised by almost everyone in the community, and it will be shown that the State is frequently an active agent in that process of economic disaster.

4. GENUINE SAVING.—Assume now that, at any given time, the community is producing capital goods such as factories, and consumption goods such as bread, clothes, &c. It produces one factory worth £50 every five weeks and therefore spends £10 per week within the factory system to pay the cost of new factory construction. At the same time it pays £90 per week for producing consumption goods, and the total amount of money emerging from, and the value of all goods produced by, the factory system is £100 per week.

Suppose that all output, capital goods as well as consumption goods, goes to the market and is sold there. Provided that none of the £100, distributed by the factory as costs of production, is prevented from reaching the market, the whole output of consumption goods and capital goods may be sold, section 2. But a new condition must be observed now. In order that all the consumption goods which cost £90 may be sold, £90 must be spent in the market to purchase them, and £10 must be spent to purchase the capital goods which cost £10. No single individual receives enough money to enable him to devote £10 per week to pay for building a new factory, but some people combine together to save £10 per week, and by saving they raise sufficient money to buy a share in the new factory. They save £10 per week, £90 remains to purchase all consumption goods, while money savers buy a £10 share in the new factory under construction. The £90 and the £10 return to the factory system to pay for more consumption goods and capital goods, £100 emerges, and again £90 buys all the consumption goods, while £10 is saved and buys another share in the new factory, and so on until the factory is completed. When one new factory is built, another may be erected, sold and bought in the same manner, and the process may continue indefinitely.

By this method of saving, all goods are sold, there is no apparent overproduction nor trade depression, and the price level of consumption goods remains unchanged at £1 per ton.

The £10 saved each week in this manner is genuine savings, for the procedure causes no economic dis-

organisation. The total amount of money which has emerged from the factory system has paid for the production of two classes of goods, and that money goes to the market where it purchases goods of equal value and in the same proportion, as regards class, as that in which they were produced. Balance is preserved between capital goods and consumption goods, all output is sold, and there are no excess goods nor excess money, see fig. 4.

The foregoing procedure shows how capital goods, or fixed capital, may be created and acquired by private owners without economic disorganisation. But before a new factory can produce goods, the owner must have trading capital or financial credit. Any individual trader who embarks in business, and thereby expands the total volume of trade, may acquire money, to act as trading capital, by saving. By saving money, he merely acquires a share of the total money or credit in circulation, other people lose what he acquires, and saving alone does not add to the total amount of financial credit in the community. The problem of creating and acquiring financial credit, other than borrowed bank credit, to act as trading capital for the purpose of financing an expansion in the gross volume of trade at a constant price level and without economic disorganisation, belongs to another branch of economics. That problem will be considered in Part II.

5. SPURIOUS SAVING AND CAPITAL GOODS.—

Profits may be earned by the possession of capital goods, and as soon as people realise that fact they all become anxious to save money by purchasing fewer consumption goods, with the intention of investing the saved money in capital goods, from which they may derive profit, interest, or dividends.

The output of the community is £90 worth of consumption goods and £10 worth of capital goods per week. In their desire to possess capital goods, people save £2 per week in addition to their previous saving of £10, with the intention of investing the whole £12 in capital goods (or profit-earning goods). The immediate result is that £2

worth of consumption goods (or non-profit-earning goods) remain unsold each week. 'Money which had been paid for the production of consumption goods in the factory has been diverted by the whole community from the purchase in the market of consumption goods of equal value, consumption goods of that value remain unsold, and the money is reserved for the purchase of, or investment in, capital goods.' That process is a form of what has been called 'Spurious Saving,' section 3. The accumulation of those unsold goods in the market week by week compels producers to restrict output. Men are dismissed, incomes and consumption are reduced, there is **apparent** overproduction, and a period of trade depression.

It may be said that the saved money will be distributed as wages to workmen engaged in the production of capital goods, and that these men will buy up the unsold goods. In the early stages of developing the industries of a country that may be so, but the process goes on continuously, and ultimately it leads to overproduction of capital goods (profit-earning goods) and to apparent overproduction of consumption goods (non-profit-earning goods), a condition which exists throughout the world to-day.

In actual practice, this economic danger of overproduction of capital goods is as keenly appreciated as the overproduction of consumption goods. It is being counteracted by the combination of industries to buy up and eliminate redundant productive capacity, instances of that process being found in the shipbuilding, chemical, wheat-milling, cotton, and other industries.

6. REGULATED EXPENDITURE OF THE NATIONAL INCOME.—

The method adopted in practice to suppress overproduction is 'Rationalisation.' That method is suitable only for the suppression of **real overproduction**, and it can never suppress **apparent overproduction**, which is the actual economic disease that afflicts the world to-day. The prevention of real overproduction, by eliminating

redundant productive capacity and by regulating output, promotes the interests of the community as well as the self-interest of producers. But self-interest in another form induces every individual, whether he be producer or consumer, to save money, and by saving too much (spurious saving) each individual perpetuates unwittingly the condition of apparent overproduction. **No matter to what degree producers may restrict output, in the expectation of curing overproduction-in-general, by methods which are applicable only to the suppression of real overproduction, money savers continue to perpetuate a condition of apparent overproduction.** All members of the community practice spurious saving out of self-interest, and by doing so they disorganise and defeat the continuous regularity of production and consumption, which is essential to their collective interest. **It is a psychological impossibility that unorganised self-interest can ever bring order out of such chaos.** Apparent overproduction can never be prevented unless spurious saving is first eliminated, and after that, the relative proportions, in which consumption (non-profit-earning) goods and capital (profit-earning) goods may be produced, sold and bought must be regulated. That regulation, which must apply to the whole community, can be operated only by the State, or by a legalised Industrial Council, or by the co-operation of both. We shall call such a regime 'The Regulated Expenditure of the National Income.' If, say, 10% of the national income is devoted to the production of and investment in capital goods, then the remaining 90% **must** be spent in purchasing consumption goods and services and in paying taxes, all of which constitute non-profit-earning goods. If a very rich man cannot consume all that he **must** buy, he may spend the balance in improving his estate, he may patronise art or research, or he may present a rifle range to his native village, &c., &c. The workmen whom he employs buy up the goods which their rich employer cannot consume, or goods of equal value, there is neither apparent overproduction nor trade depression, and unemployment is reduced.

7. SPURIOUS SAVING AND NATIONAL DEBT REPAYMENT.—Assume that the community has incurred debt. People who own the debt regard it as capital, and if it were repaid they would not spend it on consumption goods, but they would endeavour to re-invest it.

Assume that the community has adopted a regime of 'Regulated Expenditure of National Income,' and that there is no spurious saving going on. Of the gross national income, 90% is being spent in producing and buying consumption goods, and 10% is being spent in producing, and is invested in capital goods, and industry is normally prosperous. The State now begins to repay its debt by imposing a tax of £5 per week on the whole community. It pays this money to its creditors, and debt is repaid at the rate of £5 per week. Of that £5, 90% or £4.5 was paid out in the factory as part cost of producing consumption goods, while £.5 or 10% was paid to produce capital goods, and if apparent overproduction is to be avoided, the £5 must be spent in purchasing consumption goods and capital goods in the same proportions. But the whole £5 is paid to people who regard it all as capital and they wish to re-invest the whole of it in capital goods. Consequently £4.5 worth of consumption goods appear in the market each week, and they cannot be sold because the money which had been paid to produce them is reserved for purchasing capital goods. That process is another form of spurious saving, and it goes on week after week. Consumption goods accumulate in the market, there is **apparent** overproduction, prices fall, and there is trade depression. **The State is an active agent in promoting that disastrous condition.**

Spurious saving, whether practised by the State or by individuals, causes a fall in prices—the very condition which prevents the immediate return of the saved money into profit-earning industry. During 80 years from 1817 to 1897, about £250,000,000 of British national debt was repaid and prices fell from an index level of 200 to 81, notwithstanding the fact that there was a considerable temporary rise during that period, due to the production of gold in California and Australia.

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8. DEBT REPAYMENT WITHOUT TRADE DEPRESSION.—It is possible to repay national and other debt, not only without trade depression, but to repay it during a period of industrial prosperity and of social and economic reconstruction. Assume that, out of every £100 worth of output, £90 is paid in the factory for the production of consumption goods, and £10 for capital goods, and that the national income is being spent in purchasing those goods in the same proportions. Under that regime there is neither real nor apparent overproduction and prosperity is normal.

The State now begins to repay debt. It imposes a tax of £5 per week, pays the money to its creditors and debt is reduced at the rate of £5 per week. The people from whom that £5 has been taken had been spending 90% or £4.5 of it in purchasing consumption goods, and 10% or £.5 in purchasing capital goods, and prosperity was normal. The people to whom the £5 is paid regard it as capital and they would devote the whole £5 to invest in, or purchase, capital plant, thereby leaving £4.5 worth of consumption goods unsold, a process which constitutes spurious saving and leads to trade depression. That depression may be avoided by ensuring that the national income shall be spent, after debt repayment, in the same regulated proportions as those in which it was being spent when prosperity was normal, before debt repayment began, namely, 90% on the production and sale of consumption goods and 10% on the production of, and investment in, capital goods. Under such a regime there is a minimum of apparent overproduction, industry continues to prosper, and debt is repaid during a period of normal prosperity. This method of repaying debt may appear drastic, but it has been presented here as an isolated operation. When viewed as one of many operations in the complete structure of a general Industrial-Monetary Theory, of which this document is a short partial summary, the drastic nature of the process disappears. Not only may a community pay off debt, but it may undertake extraordinary expenditure, with or without borrowing, during a period of normal prosperity and constant prices.

9. BANKS—EXPORT TRADE—DEPRECIATION.—It may be pointed out that banks do not appear in the picture. Spurious saving—the primary economic vice of all money-using nations—is indulged in by everyone from the State downwards, and it has brought economic ruin on nations from time immemorial. It leaves nations with unsold goods — an 'Unbuyable Surplus,' which producers attempt to dispose of by export. The compulsory search for, and exploitation of foreign markets in which nations may sell their unbuyable surpluses is a primary cause of war. The unbuyable surplus may be small in proportion to total output, but it disorganises the whole volume of world trade. If two (or more) nations exchange their unbuyable surplus they are no better off, for neither can buy the imported surplus, which takes the place of its own exported unbuyable surplus. The unbuyable surplus can only be disposed of ultimately either by stopping production until the surplus is consumed, or by the creation of debt, and both these courses lead to poverty. The alternative to world-wide poverty is to eliminate the unbuyable surplus, and the general Theory referred to above shows that a nation which spends its income in Regulated Proportions does not produce an unbuyable surplus. It may prosper with or without foreign trade, but if it engages in export it is more favourably situated for effective competition in world markets than competitors who do not adopt that regime.

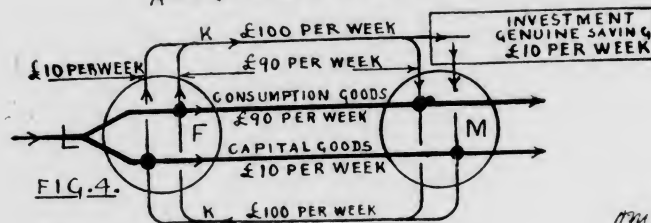
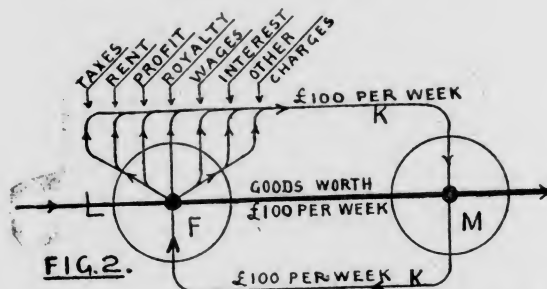
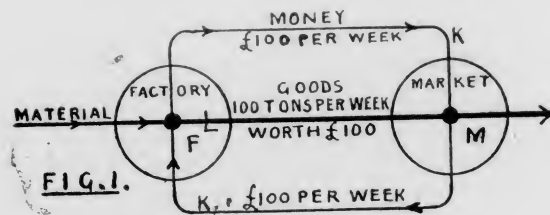
That general Theory also shows that making good depreciation or the renewal of worn out capital goods is subject to regulations similar to those applicable to new capital goods, but in a modified form.

10. OTHER FORMS OF SPURIOUS SAVING—THRIFT—INDUSTRIAL REVIVAL.—The creation of trading capital, or financial credit, has been referred to in section 4. Spurious saving enters intimately into that process, but the method of dealing with it, so as not to cause economic disorganisation, is totally different from the

methods which have been described for balancing the output of consumption goods and capital goods, see Part II.

Thrift is usually regarded as a virtue. The virtue of thrift does not lie in mere money saving, but in regulated spending. In actual practice it is not possible for an individual money saver to know whether his saving is genuine or spurious. That question can only be decided for the community as a whole, by the State, or by a legalised Industrial Council, or by both in co-operation.

Permanent amelioration of the present chaotic condition of national and of world economics is not possible so long as spurious saving and apparent overproduction continue unchecked. If these practices are eliminated by 'Regulating the proportions in which the national income may be spent to produce and purchase capital goods and consumption goods (profit-earning and non-profit-earning goods)' — which Regulation is the essence of what has been called 'Judicious Spending,' or of what may be called 'Rationalised Consumption'—then industry may be trusted to prevent real overproduction, and left to work out its own salvation without borrowed money to finance new deals, and without the issue of credit for free national dividends.



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SUPPLEMENT TO PART 1.

The accompanying diagrams represent some of the exchange processes which take place in a monetary-industrial system. The circles F, M represent the factory and market respectively. Thick lines L represent the flow of materials and goods (and of cost embodied in goods), while the thin line circuit K represents the flow of money or credit. Arrows indicate the direction of flow, and figures represent the magnitude of the rate of flow. Exchange of money for goods takes place where a money line crosses a goods line through a dot. Where the money line is broken, no exchange takes place, as in fig. 4.

In fig. 1, material enters the factory F by the line L, it is converted into goods at the rate of 100 tons per week and exchanged in the factory for £100 of money, as indicated by the dot where K and L cross. The goods, 100 tons worth £100, pass along the line L, while the money passes along the circuit K to the market M, where the 100 tons are sold for £100, again indicated by the dot where K and L cross. The goods are taken away for consumption and the money returns by the circuit K to the factory F, where it is used to pay for the production of another 100 tons of goods. Money thus flows in a closed circuit K and is used over and over again, whereas goods pass only once along the line L.

In fig. 2, factory owners distribute £100 as wages, rent, interest, &c., items which constitute the cost of marketed output. Provided that all the money, £100, thus distributed goes to market all factory output may be sold.

In fig. 3, a person 'A' saves £1 per week. Only £99 goes to market and one pound's worth of goods remain unsold. The saved money becomes trading capital and the owner returns it to the factory, along the path represented by the dotted line A, where it pays for the production of

another ton of goods, while the first ton still remains unsold. That process is spurious saving, and it is the basic cause of trade depression.

In fig. 4, £90 and £10 pass through the factory and pay for producing consumption goods and capital goods respectively each week. The £100 goes to market, where £90 is spent in purchasing consumption goods, while £10 is saved and spent in purchasing (invested in) capital goods. All money passes through the market, all goods are sold in the same proportions as those in which they were produced, the £10 invested in capital goods is genuine savings, and there is no apparent overproduction nor trade depression. But if the community buys only £80 worth of consumption goods and saves another £10 in addition to the £10 already saved, then £10 worth of consumption goods remain unsold and there is trade depression. The additional £10 is spurious saving.

This type of diagram has been developed by the Author to show how money and credit may be correctly used in industry, so as to prevent trade depression due to monetary causes under practically all circumstances. Also to show how the defects of the present system arise.

It is generally believed that the creation of financial credit to finance an expansion of industry must of necessity be accompanied by trade cycles or some form of trade depression. That belief is unjustified, and diagrams have been constructed to explain how financial credit may be expanded to finance, at a constant price level, any possible industrial expansion demanded by the community without any reduction in the standard of living to which the community may have attained. That result can only be arrived at by organisation—not by laissez faire nor by any form of financial jugglery.

Part II.

The Creation of Financial Credit.

Expanding Output.

11. TRADING CAPITAL — CREDIT. — Part of the capital with which a trader engages in business is spent in purchasing fixed plant such as machinery, and part is used for purchasing raw materials and for paying wages and other expenses incurred in the manufacture of trade goods. The former is 'fixed capital,' and the latter is 'trading capital.' From an economic point of view these two forms of capital are totally different, and we shall deal now with trading capital only, and the term 'capital' will always mean 'trading capital.'

A trader 'B' engages in business with (trading) capital of £10x. He acquires a stock of trade goods and £10x goes into circulation. His turnover is £x per week, and once every 10 weeks he (a) turns over his capital of £10x in the form of money, (b) sells his stock of trade goods, and (c) renews that stock. Similar procedure is followed by each trader, and it applies to all traders collectively. The initial trading capital of all the traders in the community was £10X. They acquired stocks of trade goods and £10X went into circulation. At any moment afterwards that £10X may exist partly or wholly as coin, bank notes, cheques, or as credit entries in bank ledgers, and the trading capital of £10X has become 'credit in circulation' or simply 'credit.' The average turnover of all traders is £X per week, they turn over their trading capital once in 10 weeks, i.e., they pay out £10X once in 10 weeks as costs of production (cost includes profit) and they receive £10X by sales. Their trading capital makes a complete circuit of the community once in 10 weeks on an average, and 10 weeks is 'the period of circulation of credit' (or of trading capital). Simul-

taneously traders sell all their stocks of trade goods and renew those stocks once every 10 weeks. Merchandise, on an average, takes 10 weeks to pass through the factory system, and 10 weeks is 'the period of manufacture and storage of goods,' which is equal to the period of circulation of credit.

Assume the conditions in our community to be as follows:—The turnover, or output, of all traders is 100 tons per week worth £100. The price level is £1 per ton. The period of circulation of credit is 10 weeks, and the total trading capital, which is equal to the credit in circulation, is £1000. The community has been producing factories, or fixed capital, by genuine saving and there has been no economic disorganisation, section 4. Whatever output may be produced by those new factories will be additional to all existing output, and traders will require additional trading capital to finance the additional turnover.

Let us assume that the turnover, or rate of output, is to be increased from 100 tons per week, worth £100, to 110 tons, or by 10 tons per week. The price level is to remain constant at £1 per ton, and therefore 110 tons will cost £110, and the additional turnover will be 10 tons per week, worth £10. Since the period of circulation of credit is 10 weeks, the additional capital required to finance the additional turnover of £10 per week is £100. The problem with which the community is faced is: 'Where is this additional trading capital to come from?'

12. BORROWED TRADING CAPITAL.—A common method of obtaining trading capital is to borrow money or credit from a bank. Banks always have customers' deposits in their possession, and they are said to lend these deposits. A trader 'B' undertakes to increase the turnover (output) of the community by £10 per week, for which he will require £100 of trading capital. He goes to a banker, deposits security, and is granted a credit of £100. He engages in business, acquires trade goods worth £100, £100 goes into circulation, and the total trading capital engaged in business,

which is equal to the total credit in circulation, is now £1100. 'B' establishes his business with a capital of £100, and his turnover is 10 tons per week worth £10. Other traders' turnover is 100 tons per week worth £100, the total turnover is 110 tons per week worth £110, and the price level is unchanged at £1 per ton. So long as 'B's' loan remains unpaid, there is nothing to prevent that turnover and that price level from continuing indefinitely, provided that the goods and money which emerge from the factory are permitted to flow to the market without interruption.

But trade loans must be repaid, and it is known from experience that when these loans are repaid 'credit is contracted' and trade depression follows. Borrowed bank credit cannot therefore support a permanently prosperous industry unless the credit remains on permanent loan. In actual practice, industry is partly financed by a permanent loan from banks. A large proportion of trading capital in modern industry is borrowed bank credit, which is lent out as short term loans. These loans are continually being repaid and re-issued, and in the aggregate these short term loans constitute a permanent loan from banks to industry. In Britain that permanent loan, on which banks draw interest of varying amounts, is about £1,000,000,000, and the interest is a tax on industry.

13. THE ACQUISITION OF TRADING CAPITAL WHICH IS NOT ON LOAN.—Traders may create and acquire the money or credit, which they require for trading capital without having to borrow it, and they may create it with or without the assistance of a private bank. There are several processes by which that additional money or credit may be created besides that of borrowing, and we shall examine four of them. The description which follows, of creating each form of credit, will serve to illustrate the principles involved, and is not necessarily the exact procedure followed in practice. That particular mode of description will be adopted for the reason that it is best suited to show the similarity and the difference between those four methods of creating credit, and because it affords

an easy method of comparing the advantages and disadvantages of each process.

14. CREDIT BASED ON PRECIOUS METALS.—

As in section 11, 'B' is to increase the turnover (or rate of output) of the community by 10 tons per week worth £10, for which operation he will require trading capital of £100, but he must acquire it without borrowing and without incurring debt. He saves £100 and goods worth £100 remain unsold. That action constitutes spurious saving, section 3, and he must prevent the trade depression which accompanies it. Accordingly he takes the money to gold miners and buys £100 worth of newly mined gold. The miners take the money and buy up the goods which 'B' had not bought, or goods of equal value. The money goes back into circulation and there is practically no apparent overproduction nor trade depression. 'B' now gets the gold minted into coin, or he sells it to the Bank of England for a cheque or for bank notes, which are additional to all those already in circulation. He deposits the cheque, notes, or coin in the private bank, employs the money in trade, establishes a business the trading capital of which is £100, acquires trade goods, and £100 of new credit goes into circulation. Turnover, or output, is increased by 10 tons per week worth £10, the gross turnover of the community is now 110 tons per week worth £110, and the price level is unchanged at £1 per ton. In combination with the mint or the Bank of England, 'B' has created credit independently of the private bank, he has not borrowed money nor incurred debt, and there has been practically no industrial disorganisation.

When 'B' sells his gold to the Bank of England it makes no difference to prices whether he takes payment in coin, in bank notes, or by cheque, or in some of all three. Money is the physical embodiment of credit, and 'B' takes the credit in that physical form most convenient for himself, his total credit remaining at £100. The additional credit of £100 now in circulation is based on a precious metal, gold, and it will be called 'Metal Credit.'

15. CREDIT BASED ON STATE DEBT.—If the community possesses no gold mines, or if gold cannot be produced in sufficient quantity (which is actually the case to-day), 'B' must devise another method of creating credit. As in sections 11 and 14, he saves £100 and leaves £100 worth of goods unsold. That action is spurious saving, and he must prevent the trade depression which accompanies that process, section 3. The State is engaged in road construction, it borrows the £100 from 'B' and pays out the money, without undue delay, to men engaged in road construction. These men take the money and buy up the goods which 'B' had not bought, or goods of equal value, the money returns into circulation, and there is practically no apparent overproduction nor trade depression. 'B' now has an interest-bearing government security, the private bank has customers' deposits which it wishes to invest, and it buys up the government security just acquired by 'B' and pays him with £100 of customers' deposits. In this manner 'B' acquires a credit of £100, which he employs in trade. He establishes a business the trading capital of which is £100, acquires trade goods, and £100 of new credit goes into circulation. Turnover is increased by 10 tons per week worth £10, the gross turnover of the community is now 110 tons per week worth £110, and the price level is unchanged at £1 per ton. In combination with the State and the private bank, 'B' has created credit without incurring personal debt, but interest-bearing debt has been imposed on the community and the private bank receives the interest. The amount of debt is equal to the amount of additional credit which has been created, or to the additional trading capital required to finance the additional turnover, which in turn is equal to the value of the additional trade goods required to support the additional turnover.

The credit which has been created by this process is based on State debt and will be called 'Debt Credit.' There appears to be no control over the amount of debt credit which may be created.

16. CREDIT BASED ON STATE ASSETS.—In order to avoid imposing debt on the community, 'B' devises another method of creating credit. As in sections 11, 14 and 15, he saves £100 and leaves £100 worth of goods unsold. That action is spurious saving, and he must prevent the trade depression which accompanies it. The State is engaged in road construction, and 'B' sells his £100 to the State for a cheque on the Bank of England Issue Dept. That cheque is a security which does not bear interest. Without undue delay the State pays out the money as wages to men engaged in road construction, these men take the money, buy up the goods which 'B' had not bought, or goods of equal value, and there is practically no apparent overproduction nor trade depression. 'B' deposits his cheque in the private bank and acquires a credit, with which he embarks in trade. He establishes a business the trading capital of which is £100, acquires trade goods, and £100 of additional credit goes into circulation. Turnover is increased by 10 tons per week worth £10, the gross turnover of the community is now 110 tons per week worth £110, and the price level is unchanged at £1 per ton. In combination with the State and the Bank of England Issue Dept., 'B' has created credit independently of the private bank, he has incurred no personal debt, he has not imposed interest-bearing debt on the community, and there has been practically no industrial disorganisation. The credit created in this manner is based on State assets, a road worth £100, and it will be called 'Asset Credit,' section 19. The amount of asset credit to be issued is regulated by a price index in combination with a constant price level.

There is absolutely no difference between asset credit, the creation of which has just been described, and debt credit, the creation of which has been described in section 15, except that the private bank does not receive interest on asset credit. The creation of any form of credit may be associated with the repayment of loans of borrowed bank credit.*

* See 'The Production of Money,' by H. Munro. Geo. Souter, Dingwall, Publisher.

17. THE FIDUCIARY ISSUE.—The traders of our community started business with £1000 of trading capital, all of which went into circulation as credit. Subsequently that amount was increased by £100, making the total credit in circulation £1100. That credit circulates in three principal forms—coin, notes, and cheques. So long as the total credit in circulation remains at £1100, the **form** in which it circulates does not affect prices, and the **proportions** of coin, notes, and cheques in which it circulates is decided by money users who use coin, notes, or cheques to suit their convenience, provided that their choice is not circumscribed by powers outwith their control.

When gold is the basis of credit, the whole amount of gold may be minted and issued as coin. As a matter of high financial expediency, gold coin is not used now, but the whole value of gold is represented in circulation by legal tender notes of equal nominal value. The public may use these notes or they may use cheques to settle their transactions.

Should asset credit be issued, 'B' would receive a cheque on the Bank of England Issue Dept., and he might draw the credit either in notes or by cheque, whichever method he may find convenient.

In the case of debt credit or borrowed bank credit, 'B' can only circulate that credit by cheque, for the private bank is debarred from printing notes. But 'B' may wish, as a matter of convenience, to use legal tender notes, and the bank may obtain them in the following manner:—'B' acquired debt credit with his bank by selling it a government security worth £100, section 15, and he wishes to pay out £50 by cheque and £50 in notes, of which the bank is short. Accordingly the bank sells half of the security which it had bought from 'B' to the Bank of England Issue Dept. for £50 in notes, which it hands to 'B,' who puts them into circulation. This issue of notes does not affect prices, for the total credit in circulation remains unchanged. The interest on the security, which has been surrendered to the Bank of England in exchange for notes, returns to the State less a commission to the Bank of England.

The £50 in notes issued in the manner just described is part of the 'Fiduciary Issue,' which consists of notes in circulation in excess of the value of gold held by the Bank of England. These notes are said to be secured by State debt, the interest on which returns to the State, i.e., they are secured by State debt on which no interest is paid. Asset credit is also State debt on which no interest is paid, and fiduciary credit and asset credit are therefore alike in principle. But whereas asset credit is issued direct, fiduciary credit is created by a circuitous, complicated and expensive process, and it is limited in quantity by law, although in an emergency it may be expanded indefinitely by the Treasury.

In the process of creating asset credit, 'B' saved £100, sold the money to the State for a cheque (a non-interest-bearing security) on the Bank of England, which entitled him to £100 of credit, which he may circulate as notes or as cheques.

In the process of creating fiduciary credit, 'B' saved £100, sold the money to the State for an interest-bearing security, and then he sold the security to the private bank for a credit of £100. The banker now sells the security to the Bank of England for bank notes, which constitute the fiduciary issue, the interest on the security is cancelled, and there is no difference between that form of credit and asset credit, for both are backed by non-interest-bearing debt or by the credit of the State.

18. TRADE CYCLES AND THE CREATION OF CREDIT. — One operation in the creation of metal, debt, asset, and fiduciary credit was that 'B' saved £100 and left £100 worth of goods unsold. Then it was assumed that the price level remained unchanged, but that does not follow automatically.

(a) In the case of debt credit—and what follows applies to the others—'B' saved money and left goods of equal value unsold. Provided that 'B' lent his money to the

State immediately he saved it, and that the State distributed the money without undue delay, the road makers who received that money bought up the unsold goods, and there was no apparent overproduction, no trade depression, and no change in the price level.

(b) But if 'B' saved the money and placed it on deposit for some time, the owners of the unsold goods, in the desire to get rid of them, would restrict production by dismissing men. Apparent overproduction and trade depression would follow, prices would fall, and ultimately the unsold goods would be cleared off the market. If the State **now** borrows the saved money from 'B' and distributes it to its road makers, that money comes on a market depleted of goods, and prices would rise. The creation of credit is now accompanied by a fall in prices followed by a rise, and there is a trade cycle.

19. ASSET CREDIT ISSUED DIRECT.—Asset credit may be issued more directly than described in section 16, and with less risk of a trade cycle. Assume that the community operates on a constant-price-level regime and that, on the average, turnover or the rate of output is doubled every 10 years, i.e., turnover expands at the rate of 10% per year. This year the trading capital of all traders is £1000 and turnover is 100 tons per week worth £100. Next year turnover will be 110 tons per week worth £110 and trading capital will be £1100. Trading capital must therefore be increased by the issue of £100 of new credit.

The State is engaged in road construction, which may be paid for either out of revenue or by borrowed money. But in order to issue new credit the State pays £2 of the cost each week with new notes or by cheques on the Bank of England Issue Dept. until £100 has been issued. At the end of the year the credit in circulation is £1100, and, the period of circulation of credit being 10 weeks, it circulates at the rate of £110 per week, an increase in turnover during the year of £10 per week. There is no change in the costs of production, and the additional £10 per week in circulation

pays for the production of 10 tons of goods per week at the rate of £1 per ton. The £100 of additional credit has become trading capital automatically, there has been practically no change in the price level, no economic disorganisation, spurious saving has been rendered unnecessary, and the main cause of trade cycles, section 18, may be eliminated.

20. GENERAL. — Industry is actually financed by borrowed bank credit, by metal credit, and by debt credit. Asset credit is in use, in a modified form and to a limited amount, as fiduciary credit. Coinage whose currency value exceeds its metal value is metal credit to the extent of its metal value—the remaining value is pure asset credit.

The maintenance of a constant price level is impossible without some form of State regulation. Even with that regulation, gold cannot support a constant price level because there is not enough of it being produced. Debt credit cannot support a constant price level simultaneous with industrial prosperity because prices fall when the debt, on which it is based, is repaid.

But with suitable State regulation, asset credit alone is sufficient to finance any possible expansion in the rate of national or of world output at a constant price level for all time. **That is a feature which is not possessed by any other form of credit which has been described here,** but credit which does possess that feature may be created by other methods than those described.

In this short summary I have not attempted to explain how the principle of 'Regulated Expenditure of the National Income' would be applied in practice, nor how asset credit would be issued to finance an expansion of industry at a constant price level. But the degree of control required to operate those factors would not be greater than the control presently exercised by the State over industry,

and would certainly be less than the degree of control fore-shadowed by the present tendency of the State to fix quotas and prices for domestic industry.

Stress has been laid on the necessity for a constant price level. A varying price level bears the same relation to credit that debased coinage bears to money. All governments have gone to great expense to standardise coinage, and a primary step in the elimination of economic chaos is the Standardisation of Credit—the abolition of debased credit—so that £1 of credit may always buy the same amount of 'average goods.'

HUGH MUNRO.

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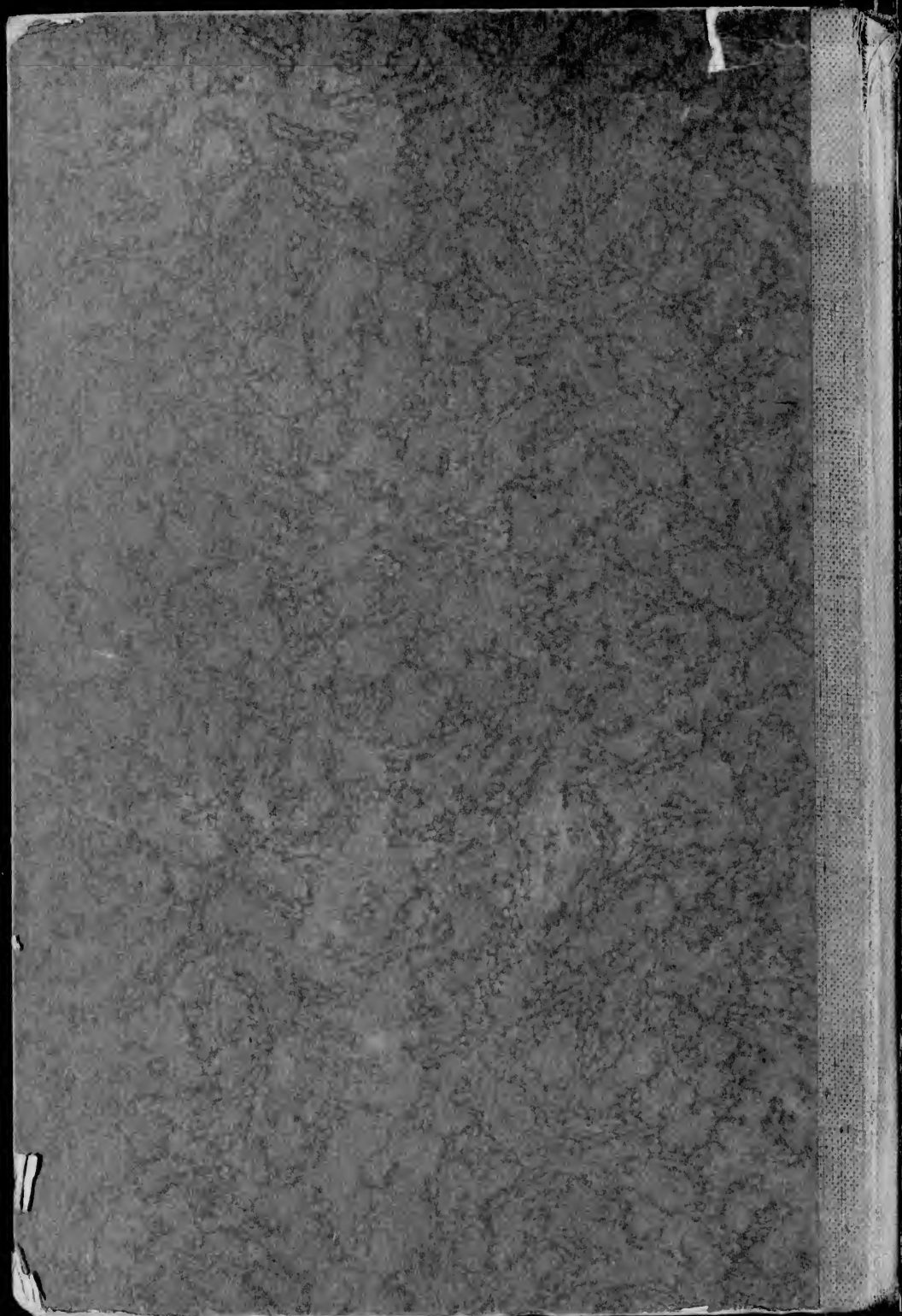
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